# JOINDRE CAPITAL SERVICES LTD.

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## RESEARCH REPORT

24th Nov 2017

# GUJARAT NARMADA VALLEY FERTILISERS & CHEMICALS LTD

**NSE : GNFC** | **Sector: FERTILISERS & SPECIALITY CHEMICALS** | **BSE: 500670**

## View - BUY

CMP : Rs. 443

Target Price: Rs 600 (In next 12 to 18 mths)

## BUSINESS BACKGROUND

GNFC is state PSU engaged in manufacturing of fertilizers and chemicals. The company also has a small business in the Information technology that supports various government departments. The company reports revenues in 3 of below segments: Fertilizer: This includes manufacturing of Urea and imported Urea. Chemicals: This includes Methanol, Formic Acid, Nitric Acid, Ethyl Acetate and TDI among others. Others Segment: This includes Information Technology business (n-Code)

## INVESTMENT HIGHLIGHTS

**Strong Financials for GNFC as on Q2 FY18 –**

GNFC reported a healthy set of Q2FY18 numbers with net sales at Rs 1506 from Rs 1462 crs, with EBIDTA placed at Rs 319.46 crs from Rs 272.49 crs in Q2 last year and the PAT in Q2 FY18 grew by 23% YoY to Rs 217 crs as compared to Rs 176. crs in Q2 last year. For H1 of FY18, Topline has totalled Rs 2561 crs, EBIDTA at Rs 491.26 crs and PAT is up at Rs 275.07 crs up by 12% YoY from Rs 245 crs.

For FY17 the company has recorded net income of Rs 4344 crs a EBIDTA of Rs 652.82 crs and a PAT of Rs 715 crs. (After Exceptional OI of Rs 292 crs)

**GNFC is a large producer of Fertlisers & Speciality Chemicals –**

GNFC has 2 plants in Bharuch and Dahej. The company has evolved from a pure play fertilizer company by forward integrating gas and ammonia used for urea production to manufacture other high margin chemicals. Urea fertilizer business is regulated by government.

GNFC fertilizer business has been showing lower profits in the past few quarters last year except for losses in very few quarters like it did in Q1FY17 last year. This poor performance of the Fertiliser division was mainly due to shifting of partial orders in the next quarter due to delayed rains in Gujarat. The likelihood of GNFC showing a reasonable profit in fertilizer is high for FY18. Secondly the chemical business of GNFC is doing well as can be seen from increasing contribution from Chemical business. The share of chemical business increased from 39% in FY12 to 60% in FY17. The trend is likely to be maintained making GNFC more of a chemical company rather than pure play fertilizer company.

### KEY DATA

| | |
|---|---|
| FACE VALUE Rs | 10.00 |
| DIVD YIELD % | 1.65 |
| 52 WK HI/LOW | 341/161 |
| NSE CODE | GNFC |
| BSE CODE | GNFC |
| MARKET CAP | RS 6891 CRS |

### SHAREHOLDING PATTERN

| | | |
|---|---|---|
| PROMOTERS | - | 41% |
| BANKS, MFs & DIIs | - | 16% |
| FIIs | - | 10% |
| PUBLIC | - | 33% |

### KEY FUNDAMENTALS

| YE | FY18 | FY19 | FY20 |
|---|---|---|---|
| Rev Gr% | 14 | 14 | 15 |
| EBIDTA Gr% | 25 | 15 | 18 |
| PAT Gr% | 123 | 23 | 20 |
| EPS Gr% | 123 | 23 | 20 |
| EPS (Rs) | 34 | 42 | 50 |
| ROE % | 12 | 13 | 14 |
| ROCE % | 8 | 9 | 10 |
| P/E(x) | 13 | 11 | 9 |

**Improvement in Profitability of TDI Plant has come to GNFC after a long time –**

The chemical business of GNFC is doing very well except for the losses from a chemical named TDI from Dahej plant. The TDI plant was envisaged when TDI prices were at multi-year high. By the time, the plant got operational, it faced losses coming instability in operation due to plant level issues and TDI prices in market fell by more than 50% leading to large losses for GNFC from this product.

As a result, TDI Dahej faced losses of Rs. 770 crores in FY15 and Rs. 352 crores in FY16. However, the loss from TDI Dahej from Q1FY17 reduced to only Rs. 34 crores for this period. The TDI Dahej plant is now running at 110% capacity utilisation as against 13% capacity utilisation in FY15 and 53% capacity utilisation in FY16.

The market price of TDI has also stabilised from its low of Rs. 90 per kg to Rs. 160 per Kg. The prices have only recently improved from Rs. 125 per kg in April2016 to Rs. 150 in July2016 and further increased to Rs. 161 in Aug2016. This has further increased to Rs 210-240 per kg in early 2017 and this makes a strong case for TDI Dahej plant to achieve a break-even and potentially aid in profitability instead of contributing negatively to the chemical business.

Higher TDI prices seem to be staying for a reasonable period: As mentioned, the TDI prices have increased to the tune of 20% in the last 3-4 weeks. Apart from improving demand, the recent sharp run-up has been partially led by a German plant shutting its 3 lakh tons capacity due to malfunction in nitric acid supply and TDI plant of Hanwha group, OCI and BASF down for maintenance purpose for a period of 1-2 months. As seen in the past, even slight change in demand – supply dynamics has always led to sharp changes in the price. The same phenomena has led to the boost in TDI prices.

Even if the TDI prices correct from its peak after a few months, they should remain at 180-200 levels giving a reasonable profit for GNFC.

**Ministry of Commerce has Imposed Anti-Dumping Duty on Import of TDI –**

Gujarat Narmada Valley Fertilizers & Chemicals (GNFC) had filed an application on 5Oct2016 in accordance with customs tariff act, 1975 for initiation of anti-dumping investigation and imposition of anti-dumping duty concerning to imports of TDI from China PR, Japan and Korea RP. GNFC has claimed that they are sole producer of TDI in India and constitute major proportion of domestic production (nearly 100% share of Domestic production). As per this application, presently anti-dumping duty is being levied on imports of TDI. This will further aid GNFC towards the TDI profitability led by stability in of higher TDI prices.

**GNFC and EcoPhos JV to help improve efficiency of Chemical Plant –**

GNFC is currently executing a 15%:85% JV with EcoPhos where GNFC has to invest a small sum of Rs. 24 crores as equity. The main purpose for GNFC JV with EcoPhos is to consume around 1.5 lakh tons of Hydrochloric acid (HCl) being produced as a byproduct in the TDI plant. Currently GNFC has to spend a reasonable amount of time and funds to treat HCl. This however, will turn into a profit making product instead of a cost burning by-product for the company once the JV starts. This JV will get operational from early 2018 onwards as per the management.

**Capital Subsidy of Rs 700 crs to be received over next 2 years by GNFC –**

GNFC underwent a capex of Rs. 1215 crores for conversion of “LSHS/FO” feed stock to “Gas”. This project was completely subsidized by government such that the reimbursement of entire cost including the interest of this project is being paid to GNFC by Government in form of capital subsidy.

This Capital Subsidy recoverable from government amounted to Rs. 1215 crores is to be receivable over a period of 5 years from the date of commencement i.e. On October 10, 2013. GNFC has already received Capital Subsidy of Rs. 627 crores including interest recoverable.

As on March 2017, GNFC is yet to receive Capital grant of Rs. 760 crores including accrued interest on subsidy till FY18. The pending capital subsidy receivable of Rs. 760 crores will help balance a large part of its long term borrowing of Rs. 1037 crores.

**GNFC aims to become debt free as capex plans are already done and no major capex envisaged –**

GNFC management appears confident that it will be in a position to become debt free in the next 12 to 18 months. This is a commendable achievement if completed as about 5 years back the total debt stood at over Rs 2500 crs. Currently total long term debt is estimated at around Rs 1700 crs and looking at the healthy cash flows being generated now and no major capex plans lined up plus expectation of capital subsidy likely to be received by the company in the next 12 to 18 months would enable the company to reduce its debt burden significantly.

**Indian Fertiliser Sector Growth outlook over the next 2-3 years look good –**

Indian Fertiliser Sector Sector Update Background: Indian Agriculture sector remains an important element for overall economic growth. However, there has been continues decline in the share of agriculture and allied sectors in India's GDP (13.7% in 2012 - 13 from 51.9% in 1950 - 51).

This was largely due to shift from traditional agrarian economy to industry and service sectors. The govt. has been increasing the focus in improving the agriculture share in total GDP. We believe Fertilisers; “an integral part of the Agriculture”, needs to be strengthened by bringing reforms in the sector. The Fertiliser sector has witnessed few positives like new fertilizer policy, easing of channel inventory into the system, softening of raw material prices globally and expectations of higher urea subsidy.

**New fertiliser policy to reduce to the urea import dependency –**

While urea consumption in India grew steadily at a CAGR of 4.1% between 2005 – 2014, production has remained stagnant with CAGR of 1.4% in the same period. The lower production is a result of lack of capacity addition due to various bottlenecks and limited availability of raw materials to some extent. In order to boost the urea production in the domestic market, the Fertilizer Ministry has approved a new fertiliser policy.

The policy talks about maximizing urea production from the urea units including through conversion of non-gas based units to gas, incentivizing additional urea production and encourage investment in joint venture projects abroad. It is also aimed at establishing a more efficient urea distribution system in order to ensure availability of urea in the remotest corners of the country. We think that this may help in bridging the widening demand-supply gap to large extent and reduce dependence on the imports of the urea.

**Fall in the key raw material prices to improve the profitability –**

Globally, the fertiliser raw material prices have been on a declining trend over the last one year. The fall in the prices has been largely on the back of global capacity addition in the fertilizer raw materials. According to the International Fertilizer Industry Association (IFA), close to 200 expansion projects for fertiliser raw materials at an investment of about $110 bn, are at an advanced stage of development.

These projects, coming up in Morocco, Saudi Arabia, China, Brazil, Canada and Russia, are expected to become operational in the next four-five years. Amongst the imported raw materials, India imports the entire potash demand, 90% of its requirement of phosphates and 25% of its requirement of urea. Hence, the fall in the prices is likely to benefit India significantly.

**Removal of restriction on neem-coated urea production to improve the margins –**

The govt. has taken steps to encourage production and availability of coated urea in the country. In this regard, the cap to produce neem-coated Urea has been removed. According to Chemicals and Fertilizers Minister Ananth Kumar, India is presently using only 60 lakh metric tons of neem-coated urea which can be increased to full demand of 310 lakh metric tons in the country. The application of neem-coated urea would help in increasing the yield with its minimum use, which would benefit the farmers. The neem-coated urea is costly by 5% compared to plain urea, but it reduces nitrogen loss by more than 10%, thereby incurring savings and improving EBITDA margin of the manufacturers

**Govt.'s policies led to major pricing difference between Urea and Complex fertilisers –**

Domestic consumption of Di-ammonium phosphate (DAP) is much lower as compared to urea, indicating imbalanced application of nutrients in India. Farmers are using excessive urea as it is cheaper than decontrolled Phosphatic (P) & Potassic (K) fertilisers such as DAP and MOP (Muriate of Potash). According to Department of Fertilisers, GoI, the ratio of NPK for Indian soil has worsened as it has increased from 4:2:1 in FY10 to 8.2:3.2:1 in FY14, which adversely impacts the soil health.

The govt. policies can also be attributed to large difference between the price of urea and non-urea fertilisers. Urea is highly subsidised and is sold at Rs 5,360 per tonne as against the average production cost of over Rs 20,000 per tonne in 2013-14. Govt. pays 70-75% of total cost of production per tonne as subsidy, while in P and K fertilizers the central govt. pays 25-40% of total cost of production as subsidy. Hence, increasing imbalanced use of nutrients has made it imperative for the govt. to take measures to promote balanced use of fertilisers by bringing down urea consumption that has resulted in a huge subsidy bill and affected soil health.

**GNFC enjoys a reasonably good balance sheet and both Topline and Bottomline growth is likely to remain strong going ahead –**

GNFC enjoys a reasonably strong balancesheet with a debt burden of Rs 1500.crs as on FY17 as compared to a tangible networth of Rs 4054 crs as on March 2017.

We expect that going ahead overall bottomline growth in the next 3 years starting FY17 onwards should easily increase at a CAGR of 17-18% and with capex unlikely to be high, we believe that net cash flows generated will remain healthy going ahead.

**What is GNFC's key USP visa other players –**

Firstly GNFC is India's largest TDI player in the industry with a capacity of 67000 tpa

Secondly GNFC enjoys a market share in excess of 50% and is likely to benefit significant benefits in the years to come as demand for TDI continues to grow at a healthy 7-8% pa

Thirdly GNFC's fertiliser business is also expected to benefit from a reduction in GST rates from 12% earlier to 5% currently and with a good monsoon offtake of fertilisers and profitability is expected to remain better this year.

GNFC plans to repay its debts significantly in the next 12 to 18 months. This is a big positive and will enhance the profit earnings capacity of the company significantly and make its business less risk prone and financially healthy.

**Business Outlook & Stock Valuation –**

On a rough cut basis, in FY18, Revenue is expected to touch Rs 4952 crs.

On the bottomline level we expect the company to record a PAT of Rs 530 crs in FY18E. Thus on a conservative basis, GNFC should record a EPS of Rs 34 for FY18E. For FY19E and FY20E our expectation is that earnings traction for GNFC will continue to remain strong wherein we expect a EPS of Rs 42 and Rs 50 respectively.

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The GNFC stock trades at a P/E of 13x and 11x based on FY18E and FY19E, which looks attractive considering its strong execution capability, financial track record and healthy industry trends in the Speciality Chemicals especially looking at GNFC's presence here.

GNFC is a leading manufacturer of TDI where it has a dominant 50% market share and we have of late seen a surge in the prices of TDI because of disruption in China, Japan and Korea. That is tremendously positive for this company. To add to this, this company would be a major beneficiary of good monsoon, farm loan waiver and the government's focus on rural economy.

To add to this all, the recent reduction in GST rates on fertilisers from the earlier fixed 12% to 5% also would be positive. Also the company has been appointed as a nodal agency for digitalisation of residential townships by NITI Aayog which would also be a big positive. All in all, this is a good stock and at the current levels, it trades at a reasonable valuations.

Hence we believe that the GNFC stock should be purchased at the current price for a price target of around Rs 600 over the next 12 to 18 months based on 12x FY20E.

## FINANCIALS

| For the Year Ended March RsCrs | FY17A | FY18E | FY19E | FY20E |
|---|---|---|---|---|
| Net Sales | 4344.31 | 4952.51 | 5645.87 | 6492.75 |
| EBIDTA | 652.82 | 817.16 | 937.21 | 1103.77 |
| EBIDTA % | 15.03 | 16.50 | 16.60 | 17.00 |
| Interest | 203.44 | 150.00 | 110.00 | 85.00 |
| Depreciation | 251.44 | 260.00 | 270.00 | 280.00 |
| Non Operational Other Income | 224.88 | 225.00 | 225.00 | 225.00 |
| Profit Before Tax | 715.05 | 632.16 | 782.21 | 963.77 |
| Profit After Tax | 528.79 | 530.1 | 650.1 | 778.2 |
| Diluted EPS (Rs) With EOI | 34.02 | 34.11 | 41.83 | 50.07 |
| Diluted EPS (Rs) without EOI | 15.24 | 34.11 | 41.83 | 50.07 |
| Equity Capital | 155.42 | 155.42 | 155.42 | 155.42 |
| Reserves | 3899.1 | 4429.21 | 5079.21 | 5857.41 |
| Borrowings | 1500.1 | 1150.1 | 750.1 | 350.1 |
| GrossBlock | 4409.91 | 4534.91 | 4684.91 | 4884.91 |
| Investments | 816.08 | 816.08 | 816.08 | 816.08 |

**Source Company our Estimates EOI – Extra Ordinary Other Income**

## KEY CONCERNS

Drop in TDI prices could impact GNFCs profitability

Any monsoon failure and slower subsidy clearance by the govt could also impact GNFC’s financials

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